



Robert W. Wood

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IRS Pays Billions In Bogus Refunds---But Legit Refunds Still Get Audited

The IRS has had a string of recent failures, but paying out bogus refunds is particularly embarrassing. The IRS knows it is happening, knows which tax credits and refunds are targeted, and still can't seem to stop it. President Obama even called for a fix back in 2009 in an executive order.

The IRS is looking into it. And a new report says there's no solution in sight. The IRS paid out \$132 billion in bogus tax credits over the last decade. The Treasury Inspector General for Tax Administration reports that [the IRS is not in compliance with Executive Order 13520 to reduce improper payments](#). The IRS has had several warnings.

In fact, in 2009, President Obama told the IRS and other agencies to reduce erroneous payments. Executive Order 13520 requires the IRS to ensure access and participation in certain tax credit programs by eligible individuals.



Tax Refund Received (Photo credit: swanksalot)

The IRS says nearly 80% of eligible people claim the earned income tax credit. But the huge group of bogus payouts is because of the complexity, the IRS claims.

It doesn't seem that complex. The Earned Income Tax Credit is a type of welfare program to hand out money to the working poor. Significantly, it's a **refundable** tax credit. That means you can claim it even if you pay no income tax whatsoever.

The IRS is pleased that nearly 80% of those eligible for it are claiming the credit. But 21% to 25% of all the claims in 2012 were improper, the report claims. That means \$11.6 billion to \$13.6 billion was misspent. The IRS says it is trying to reduce the bogus payments, but it still needs to encourage people to claim the credit.

Could the IRS try to recoup the erroneous payments once made? That's also quite a challenge, which is in stark contrast to the normal situation befalling taxpayers. If you get an extra large [tax refund](#), the conventional wisdom is that you shouldn't use the money until you're sure it's yours, and until you receive an IRS notice explaining it.

[Stephen McDow](#) of Laguna Beach, California learned this the hard way. He wasn't just made to give up the erroneous refund. He was actually [jailed](#) for spending a generous \$110,000 refund the IRS erroneously deposited in his bank account.

The refund was **meant** for a woman who had requested to have the funds deposited in her Citibank account. She gave the IRS her **old** Citibank account number—not knowing it had been reassigned to [Mr. McDow](#). Erroneous tax refunds happen more frequently than you might imagine.

You might think getting a tax refund means your return has been examined before your payment is issued. However, the fact that you receive a tax refund doesn't mean that your return has been audited or approved. The IRS generally has [three years](#) to audit your return. Often, a refund will be processed and the audit will come *later*.

[Amended tax returns](#) are even more vulnerable. If your situation isn't clear, get some advice from an accountant or tax lawyer. And don't spend the money unless you're sure it's yours.

Does the fact the IRS does this sort of thing frequently mean the IRS can stop the bogus refunds or recoup them once made? The jury is still out.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.